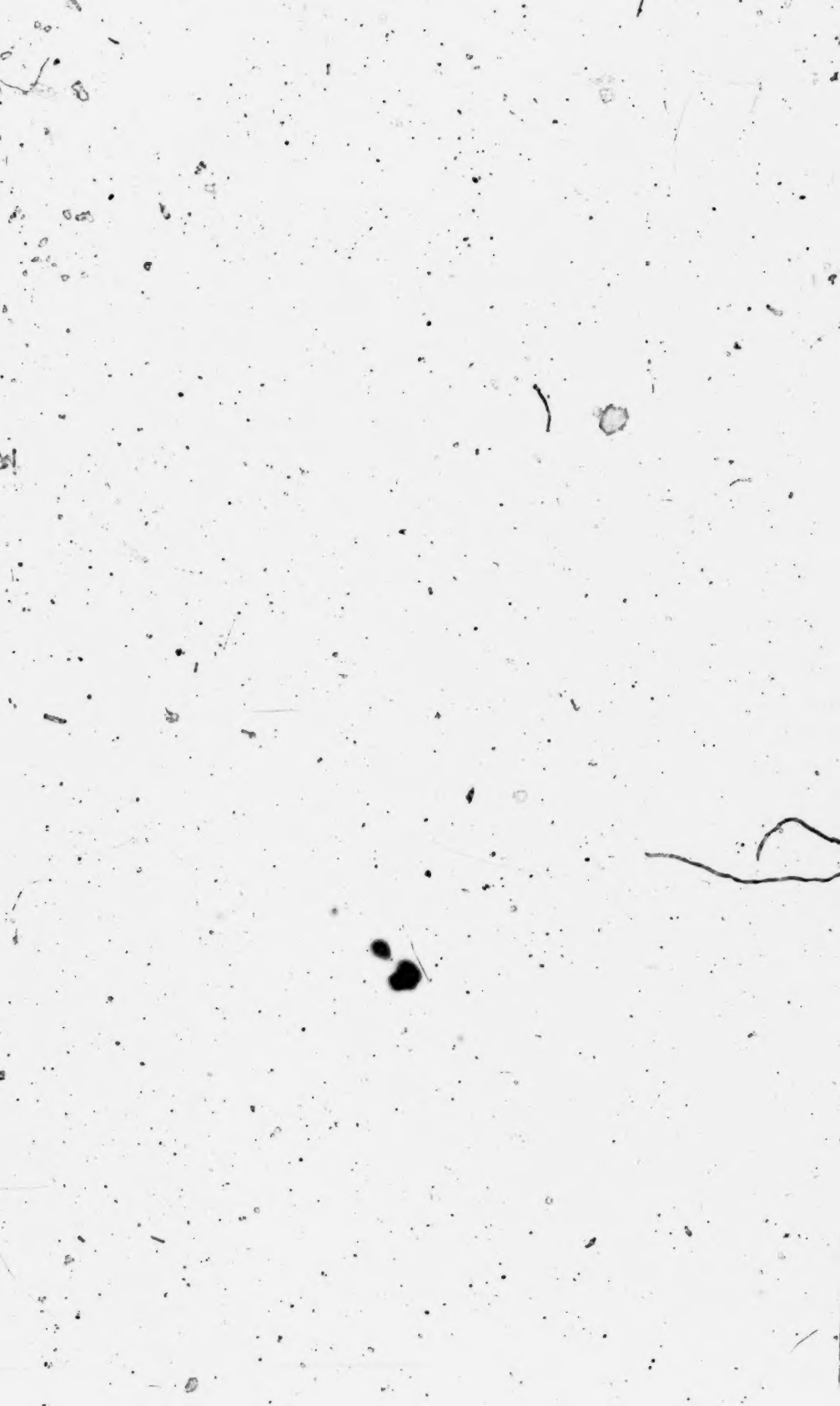


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No. 652

In the Supreme Court of the United States

OCTOBER TERM, 1961

E. E. R. SHAPIRO AND RUBYE SHAPIRO, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

ARCHIBALD COX,
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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	3
Conclusion	7
Appendix	8

CITATIONS

Cases:	
Commissioner v. *Hansen*, 360 U.S. 446	3, 4, 5, 6
Dalton & Ely Motor Co. v. *United States*, decided July 10, 1961, pending on appeal (C.A. 6)	6
General Gas Corp. v. *Commissioner*, 293 F. 2d 35, petition for certiorari pending, No. 633, this Term.	3, 4
Morgan v. *Commissioner*, 277 F. 2d 152	3, 4, 5
Smith Motors, Inc. v. *United States*, decided August 8, 1961, pending on appeal (C.A. 2)	6
United States v. *Colonial Chevrolet Corp.*, 360 U.S. 716	3
United States v. *Hine Pontiac*, 360 U.S. 715	3
Wiley v. *Commissioner*, 266 F. 2d 48, certiorari denied, 361 U.S. 831	4, 6
Statute:	
Internal Revenue Code of 1939 (26 U.S.C. 1952 ed.):	
Section 41	2, 8
Section 42(a)	2, 8
Miscellaneous:	
Treasury Regulations 111, Section 29.41-1	2, 9

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 143–161) are not officially reported. The opinion of the Court of Appeals (Pet. App. v–viii) is reported at 295 F. 2d 306.

JURISDICTION

The judgment of the Court of Appeals was entered on September 7, 1961. (Pet. App. ix.) A timely petition for rehearing was denied on October 13, 1961. (Pet. App. x.) The petition for a writ of certiorari was filed on January 9, 1962. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

The accrual basis taxpayer sold used automobiles on credit and sold his conditional sales contracts to a finance company, receiving in exchange both cash and credits to a reserve account in its name on the books of the finance company. The question is whether the entire amounts credited on the books of the finance company, including payments for the right to receive finance charges, were taxable income to the taxpayer in the year when credited.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Sections 41 and 42(a) of the Internal Revenue Code of 1939 and of Section 29.41–1 of Treasury Regulations 111 (1939 Code) are set forth in the Appendix, *infra*, pp. 8–9.

STATEMENT

The accrual basis taxpayer[1] sold used automobiles on credit. Conditional sales contracts covering these dealings showed separately the amount due on the cash selling price, the cost of insurance premiums, registration and title fees, and the finance charges or the "time price differential." The time price differential was any figure to which the taxpayer could get the customer to agree. These contracts were sold to Pacific Finance Company (hereinafter referred to as Pacific). When Pacific bought a contract it paid the taxpayer an amount in cash equal to the face amount of the contract exclusive of the finance charges. Ad-

[1] E. E. R. Shapiro is referred to herein as the taxpayer. His wife is a petitioner since all of the income in the taxable years was community income.

ditionally, it credited to taxpayer's "dealer['s] reserve account" on its books an amount equal to the finance charges less a $7.50 handling charge and less the interest charged by the finance company.

The "dealer's reserve account" set up by Pacific secured the taxpayer's guaranty of the contract payments and its other liabilities to Pacific. Partial payment of the amounts credited to the dealer's reserve account was made to the taxpayer when, in the judgment of Pacific, the reserve was larger than necessary to meet the requirements of the guaranty. The taxpayer was beneficially entitled to all amounts credited to the reserve, subject only to his liabilities to Pacific. (R. 158.)

During the taxable years involved, the taxpayer included in income, and reported, only the sums actually received from Pacific in cash. (R. 155.) The Tax Court held that the amounts credited to the dealer's reserve account were accruable and taxable to the taxpayer in the year in which they were credited. (R. 159.) The Court of Appeals affirmed. (Pet. App. v–viii.)

ARGUMENT

1. The decision below is correct; there is no conflict in decisions; nor is there any other reason warranting further review. The Court below correctly applied the controlling principles set forth in *Commissioner* v. *Hansen*, 360 U.S. 446,[2] albeit to a vary-

[2] See also *United States* v. *Hine Pontiac*, 360 U.S. 715; *United States* v. *Colonial Chevrolet Corp.*, 360 U.S. 716; *General Gas Corp.* v. *Commissioner*, 293 F. 2d 35 (C.A. 5th), petition for certiorari pending, No. 633, this Term; *Morgan* v.

ing factual situation as to which this Court expressly declined comment in *Hansen*. In that case, as here, it was contended that the dealer need not accrue finance charges credited to the dealer's reserve account until those charges were earned by the finance company. While this Court in *Hansen* declined to pass upon the contention—holding only that the taxpayers had "wholly failed to sustain the burden of showing that any part of the amounts credited on the books of the finance companies to the respective Dealers Reserve Accounts was entitled to special treatment"[3]—the principles which it announced have been correctly applied by a number of courts of appeals to sustain accrual of the entire amounts credited to dealers' reserves, including portions attributable to finance charges. *Morgan* v. *Commissioner*, 277 F. 2d 152 (C.A. 9th); *Wiley* v. *Commissioner*, 266 F. 2d 48 (C.A. 6th), certiorari denied, 361 U.S. 831; *General Gas Corp.* v. *Commissioner*, 293 F. 2d 35 (C.A. 5th), petition for certiorari pending, No. 633 this Term.

There is no basis for distinguishing between portions of a dealer's reserve representing payments for the right to receive (a) finance charges from the retail customer and (b) the cash sale price. Whatever distinct identity each may have had as an obligation of the customer to the dealer was lost, so far as the dealer is concerned, when he exchanged it for the undifferentiated obligation of the finance company. The time of accrual as to either category is determined by the nature of the obligation the dealer receives from the

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Commissioner, 277 F. 2d 152 (C.A. 9th); and *Wiley* v. *Commissioner*, 266 F. 2d 48 (C.A. 6th), certiorari denied, 361 U.S. 831.

[3] 360 U.S. 446, 469.

finance company and not by the nature of the obligation the dealer sells to the finance company. After the taxpayer-dealer in the instant case sold the right to receive finance charges from his customer, he no longer had a right to receive anything in the nature of interest for the use of his money over a period of time; and although the finance company received interest payments from the retail purchaser, the taxpayer-dealer, who had lent nothing to the finance company, did not receive interest payments from that company. He received, rather, an immediately accruable obligation of the finance company to pay "the full amount of the contract balance, less its discount consisting of its specific charge and a percentage of the total contract balance." (Pet. App. iv.)

There is no merit in the contention (Pet. 10–11) that the possibility of a loss of some part of the time price differential (by prepayment or by default on contracts) forecloses accruability of the amounts credited to the dealer's reserve. The possible diminution of Pacific's obligation to the taxpayer in the event of prepayment or default by the retail purchasers is nothing more than the consequence of conditions subsequent to the taxpayer's present and fixed right eventually to receive the total amounts credited to him in the dealer's reserve account (either in cash or by offset of his obligations to Pacific against the amounts credited to the reserve account). (R. 146.) In *Morgan* v. *Commissioner*, *supra*, it was held that the diminution of a reserve because of prepayment did not affect accruability; and, as the court below pointed out (Pet. App. vii), the proportionate debiting of reserves in both the *Hansen* and *Morgan* cases,

supra, upon default by purchasers did not impair accruability.

Nor, as the taxpayer suggests (Pet. 9, 12, 14–15), are *Hansen* and *Wiley, supra*, inapplicable here simply because Pacific reserved to itself full discretion as to when payments from the dealer's reserve were to be made to the taxpayer. As the Court below properly observed (Pet. App. viii), "when the reserve exceeded the amount of taxpayers' liabilities, direct and contingent, the excess was payable" and "[i]f there was uncertainty as to the time when taxpayer was entitled to payment, it resulted not from any question as to his right to the reserve but from the existence of counterbalancing direct and contingent liabilities."

The asserted conflict with the district court decision in *Dalton & Ely Motor Co.* v. *United States* (E.D. Ky.), decided on July 10, 1961, and now pending on appeal to the Sixth Circuit, is plainly no basis for certiorari.[4]

[4] The other district court decision claimed to be in conflict—*Smith Motors, Inc.* v. *United States* (D. Vt.), decided August 8, 1961—involved the accruability of finance charges by a dealer who held his own paper and did not, as here, sell it to a finance company.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Attorneys.

MARCH 1962.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42 [as amended by Sec. 114, Revenue Act of 1941, c. 412, 55 Stat. 687]. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) *General Rule.*

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under

section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

Treasury Regulations 111 (1939 Code):

SEC. 29.41–1. *Computation of Net Income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42–1 to 29.42–3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

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